

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:CORP:2-PLR-102678-02**

Date:

**June 19, 2002**

### Legend

Distributing =

Controlled =

Corporation X =

Country A Entity =

Country A Sub =

Country B Sub =

Country C Sub =

Country D Sub =

Country E Sub =

Country F Sub =

Country G Sub =

Country H Sub =

Country I Sub =

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Country J Sub =

Country J Branch =

Country K Branch =

Country L Sub =

Business A =

Business B =

Business C =

State X =

Country A =

Country B =

Country C =

Country D =

Country E =

Country F =

Country G =

Country H =

Country I =

Country J =

Country K =

Country L =

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Country M =

a =b =c =d =e =

Dear

This is in response to your authorized representative's letter dated January 10, 2002, requesting rulings on behalf of Distributing with respect to a proposed transaction. Additional information was received in letters dated March 21, 2002, March 25, 2002, April 22, 2002, May 1, 2002, and May 23, 2002. The material information submitted is summarized below.

Distributing is a publicly traded State X corporation engaged directly and through subsidiaries in Business A and Business B, which includes Business C. Distributing is the common parent of an affiliated group of corporations filing a consolidated return on the basis of a fiscal year ending September 30. Distributing previously received a private letter ruling, dated May 8, 2001 (the "Prior Ruling") relating to a proposed spin-off of Distributing's Business B business. Distributing no longer intends to spin off Business B (other than Business C, as discussed below). It does still intend to separate Business B (other than Business C) from Business A, by dropping Business A to a subsidiary the stock of which will be distributed to Distributing shareholders. That proposed transaction has been delayed.

Immediately prior to the distribution of the Controlled stock as described below, Distributing will have outstanding approximately a shares of common stock and b shares of preferred stock. Each outstanding share of Distributing common stock also evidences one preferred share purchase right, that is, a right to purchase a fraction of a share of Distributing preferred stock upon the occurrence of certain specified triggering events.

Financial information has been received indicating that Business A, the Business B sectors other than Business C, and Business C have each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five fiscal years.

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In order to facilitate a business combination of Business C through a merger with Corporation X, a corporation unrelated to Distributing, and in order to allow both Distributing and Corporation X to focus more efficiently on the development of their respective businesses, Distributing proposes the following series of transactions:

1. Distributing has formed a subsidiary corporation, Controlled.
2. Distributing will contribute its Business C assets, including the stock of certain subsidiaries, to Controlled (the "Contribution").
3. Distributing will distribute on a one-for-one basis all the shares of Controlled to the Distributing shareholders (the "Distribution") except for a small number of Controlled shares to be retained by Distributing (the "Retained Shares") as described below.
4. Controlled will merge into Corporation X in a transaction intended to qualify under § 368(a)(1)(A) of the Code (the "Merger"), with Corporation X surviving the Merger. In the Merger, each Controlled shareholder will receive c shares of Corporation X stock in exchange for one share of Controlled stock. Cash will be paid in lieu of fractional shares of Corporation X in the Merger. The Corporation X shareholders will acquire less than 50% of the combined voting power and less than 50% of the total value of the merged company in the Merger.

Following the Distribution, Distributing will retain no more than d% of the Controlled shares (the "Retained Shares") in order to permit Distributing to deliver both Distributing shares and Corporation X (following the Merger) shares at such time as stock awards to the employees of Distributing's businesses other than Business C vest under Distributing's performance plan.

Distributing owns all of the interests in Country A Entity, a Country A entity that has elected classification as a disregarded entity for federal income tax purposes. Country A Entity is therefore treated as a branch of Distributing. Country A Entity owns all of the interests in Country A Sub, a Country A corporation, except for e% held by unrelated third-party shareholders. Country A Sub owns both Business C assets and other assets. Distributing plans to take the following steps to separate the Business C assets from Country A Sub: (1) Country A Sub will create a new subsidiary ("New Country A Sub"); (2) Country A Sub will contribute its Business C assets to New Country A Sub; (3) Country A Sub will distribute its stock in Business C Sub to Country A Entity; (4) Country A Entity will distribute its stock in New Country A Sub to Distributing; (5) Distributing will contribute its stock in New Country A Sub to Controlled.

Distributing has actively tried to sell to a third party Country B Sub, a first-tier Distributing subsidiary engaged in manufacturing Business C products and other

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products, located in Country B, and certain related property directly held by Distributing. Distributing has now decided that rather than sell Country B Sub and the related property to another third party, Distributing will sell Country B Sub and the related property to Corporation X, following the Distribution and the Merger, in the following series of transactions: (1) Distributing will transfer to Corporation X the stock of Country B Sub and any US-based assets associated with the Country B manufacturing facility operation in exchange for a Corporation X note with a face value equal to the fair market value of the stock and the assets transferred; (2) Distributing will sell to Country B Sub the Country B assets directly held by Distributing in exchange for a Country B Sub note with a face value equal to the fair market value of the Country B assets ; (3) Distributing will exchange the Country B Sub note for a Corporation X note with the same face value; and (4) Corporation X will contribute the Country B Sub note to Country B Sub and the note will be canceled. Distributing expects to recognize gains on the sales of Country B Sub and the related property.

Distributing owns directly all of the stock of in the following subsidiaries: Country C Sub, a Country C company; State X Sub, a State X corporation that has Business C assets in Country D; Country E Sub, a Country E corporation; Country F Sub, a Country F company; Country G Sub, a Country G company; Country H Sub, a Country H company, Country I Sub, a Country I corporation, and Country J Sub, a Country J corporation. Country I Sub owns all of the interests in Country D Sub, a Country D company.

Country J Sub owns all of the interests in Country J Branch, a Country J company, Country K Branch, a Country K company, and Country L Sub, a Country L company. For federal income tax purposes, Country J Branch and Country K Branch are disregarded entities and Country L Sub is a corporation. Country J Branch also has Business C assets in a branch in Country M ("Country M Branch").

Distributing plans to separate the Business C assets of Country D Sub, Country F Sub, and Country L Sub, in the following manner: (1) Distributing will form new subsidiaries in Country D ("Country D New Sub") and Country F ("Country F New Sub"), and a new branch of Country J Branch in Country L ("Country L Branch").. (2) Distributing will contribute cash in the amount of the value of the non-Business C assets held by Country D Sub, Country F Sub, and Country L Sub to Country D New Sub, Country F New Sub, and Country L Branch, respectively. (3) Country D Sub, Country F Sub, and Country L Sub will sell their non-Business C assets for cash to Country D New Sub, Country F New Sub, and Country L Branch, respectively. (4) Country J Sub will distribute its stock in Country L Sub to Distributing.

Distributing will contribute its stock of Country F Sub, Country I Sub (which owns Country D Sub), and Country L Sub to Controlled.

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Distributing plans to separate the Business C assets of Country G Sub, Country K Branch, Country J Branch, Country C Sub, Country H Sub, Country E Sub, Country D Sub and Country M Branch in the following manner: (1) Distributing will form new subsidiaries in Country G ("Country G New Sub"), Country K ("Country K New Sub"), Country J ("Country J New Sub"), and the United States ("U.S. New Sub"). (2) Distributing will contribute cash to Country G New Sub, Country K New Sub and Country J New Sub in the amount of the wireless communications assets held by Country G Sub, Country K Branch and Country J. Branch, respectively. Distributing will also contribute cash to U.S. New Sub in the amount of the combined Business C assets of Country C Sub, Country H Sub, Country E Sub, Country D Sub, and Country M Branch. (3) Country G Sub, Country K Branch, and Country J Branch will sell their Business C assets for cash to Country G New Sub, Country K New Sub, and Country J New Sub, respectively. Country C Sub, Country H Sub, Country E Sub, Country D Sub, and Country M Branch will sell their Business C assets for cash to U.S. New Sub. (4) Distributing will contribute all of its stock in Country G New Sub, Country K New Sub, Country J New Sub, and U.S. New Sub to Controlled.

The transactions described in the immediately preceding six paragraphs are referred to hereinafter as the Foreign Restructuring Transactions.

The following representations have been made in connection with the Contribution and the Distribution:

- (a) The Retained Shares are being retained to permit Distributing to deliver both Distributing shares and Corporation X (following the Merger) shares at such time as stock awards to the employees of Distributing's businesses other than Business C vest under Distributing's performance plan. The Corporation X shares received by Distributing in the Merger for the Retained Shares will be disposed of as soon as the vesting period for such awards expires and, in any event, not later than five years after the date of the Distribution.
- (b) The retention of the Retained Shares is not pursuant to a plan having as one of its principal purposes the avoidance of federal income tax.
- (c) Distributing will vote the Corporation X shares received in the Merger in exchange for the Retained Shares in proportion to the votes cast by Corporation X's other shareholders.
- (d) A distribution of all of the stock of Controlled would not be treated to any extent as a distribution of "other property" under § 356.

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- (e) Any indebtedness owed by Controlled or Corporation X (following the Merger) to Distributing after the Distribution will not constitute stock or securities.
- (f) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (g) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (h) Following the Distribution, Distributing and Controlled (and after the Merger, Corporation X) will each continue the active conduct of its business, independently and with its separate employees.
- (i) The Distribution is carried out for the following business purposes: to facilitate a business combination of Distributing's Business C with Corporation X through a subsequent merger of Controlled into Corporation X; and to allow both Distributing and Corporation X to focus more efficiently on the development of their respective businesses. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.
- (j) Except for the Merger, there is no plan or intention by any shareholder who owns 5% or more of Distributing, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled (or, after the Merger, Corporation X) after the transaction.
- (k) There is no plan or intention by Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of § 4.05 (1) (b) of Rev. Proc. 96-30.
- (l) Except for: (i) the Merger, (ii) the sale of Country B Sub and the related property to Corporation X as described above, and (iii) the proposed spin-off by Distributing of Business A, there is no plan or intention to liquidate Distributing or Controlled (or, after the Merger, Corporation X), to merge either corporation with any other corporation, or to sell or otherwise

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dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

- (m) For purposes of §355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50% or more of the total combined voting power of all classes of Distributing or Controlled stock entitled to vote, or 50% or more of the total value of shares of all classes of Distributing or Controlled stock, that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying §§ 355(d)(6)) ending on the date of the Distribution.
- (n) The Distribution and the Merger are not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50% or more of the total combined voting power of all classes of either Distributing stock or Controlled stock (or, after the Merger, Corporation X stock) entitled to vote, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled (or, after the Merger, Corporation X).
- (o) The total adjusted bases and the fair market value of the assets to be transferred by Distributing to Controlled each equals or exceeds the sum of the liabilities (if any) assumed by Controlled plus any liabilities to which the transferred assets are subject; and the liabilities assumed in the transaction and to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (p) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (q) Except with respect to any future obligations arising out of the continuing relations described above, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock. If any indebtedness is owed by Controlled to Distributing after the distribution of the Controlled stock, such indebtedness will not constitute stock or securities.
- (s) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D.



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8597). Further, Distributing's excess loss account, if any, with respect to the Controlled common stock will be included in income immediately before the Distribution (see § 1.1502-19).

- (t) Except pursuant to certain short-term transitional agreements, payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (u) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (v) Neither Distributing nor Controlled will have been a U.S. real property holding corporation (USRPHC) at any time during the five-year period ending on the date of the Distribution and none of Distributing, Controlled, nor to the best of Distributing's knowledge, Corporation X, will be a USRPHC immediately after the Distribution.

The following representation has been made in connection with the Merger:

- (w) The payment of cash in lieu of fractional shares of Controlled in the Merger is solely for the purposes of avoiding the expense and inconvenience to Corporation X of issuing fractional shares and does not represent separately bargained-for consideration. The method used for handling fractional share interests is designed to limit the amount of cash received by any one shareholder to less than the value of one full share of Controlled common stock.

Based solely on the information submitted and the representations made, we have concluded that:

- (1) The transfer by Distributing to Controlled of the assets as described above, followed by the pro rata distribution of all its Controlled stock (other than the Retained Shares, as described above) is a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of its Business C assets, including certain stock, to Controlled in exchange or constructive exchange for Controlled stock and the assumption by Controlled of certain liabilities. Sections 361(a) and (b) and 357(a).

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- (3) No gain or loss will be recognized by Controlled on the receipt of the assets described above in exchange for Controlled stock. Section 1032(a).
- (4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the exchange described above increased by the gain, if any, recognized by Distributing. Section 362(b).
- (5) The holding period of each asset received by Controlled will include the period during which such asset was held by Distributing before the Contribution. Section 1223(2).
- (6) No gain or loss will be recognized by Distributing upon the distribution of all the Controlled stock (other than Retained Shares, as described above) to the Distributing shareholders. Section 361(c)(1).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders upon receipt of the Controlled stock. Section 355(a)(1).
- (8) The aggregate basis of the Distributing and the Controlled stock in the hands of the Distributing shareholders immediately after the Distribution will be the same as the aggregate basis of the Distributing stock held by the Distributing shareholders immediately before the Distribution, allocated in accordance with § 1.358-2(a)(2) of the Regulations. Section 358(c).
- (9) The holding period of the Controlled stock received by the Distributing shareholders will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of Distribution. Section 1223(1).
- (10) Proper allocation of earnings and profits will be made between Distributing and Controlled under § 312-10(a) of the Regulations. Section 312(h).
- (11) Payments made by Distributing to Controlled or by Controlled to Distributing under the tax sharing agreement (i) that have arisen or will arise for a taxable period beginning on or before and ending after the Distribution and (ii) that will not become fixed and ascertainable until after the Distribution will be treated as occurring immediately before the Distribution. See Arrowsmith v. Commissioner, 344 U.S. 6 (1952)

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- (12) Assuming the Merger qualifies as a reorganization under § 368(a)(1)(A), the payment of cash in lieu of fractional share interests in Corporation X will be treated for federal income tax purposes as if the fractional shares were issued as part of the exchange and then were redeemed by Corporation X. The cash payments will be treated as having been received as distributions in full payment in exchange for the stock redeemed as provided in § 302(a). Provided that the fractional share interest is a capital asset in the hands of the exchanging shareholder, the gain or loss will constitute capital gain or loss subject to the provisions and limitations of §§ 1221 and 1222.

No opinion has been expressed as to the tax treatment of the transactions under other provisions of the Code or Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above ruling. Specifically, no opinion has been requested and none is expressed as to the qualification of the Merger under § 368(a) of the Code. Further, no opinion is expressed regarding the international tax consequences of the transactions, including:

- (a) the application of § 482 to any of the taxable asset transfers involving the Foreign Restructuring Transactions;
- (b) the consequences under § 367 in respect of any of the Foreign Restructuring Transactions;
- (c) the applicability of § 1503(d) to any dual resident corporation that (1) is no longer a member of the Distributing consolidated group by reason of the Distribution, or (2) that is involved in a putative triggering event in connection with any internal restructuring transaction;
- (d) whether any or all of the above-referenced foreign corporations are passive foreign investment corporations within the meaning of § 1297(a) of the Code. If it is determined that any or all of the above-described foreign corporations are passive foreign investment corporations, no opinion is expressed with respect to the application of §§ 1291 through 1298 to the proposed transactions. In particular, in a transaction in which gain is not otherwise recognized, regulations under § 1291(f) may require gain recognition notwithstanding any other provision of the Code.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by the signature of an

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appropriate party under penalties of perjury. This office has not verified any of the materials submitted in support of the ruling request. The taxpayer, as part of the audit process, may be required to verify the information, representations, and other data provided. This letter is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

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Charles M. Levy  
Reviewer, Branch 2  
Office of Associate Chief Counsel (Corporate)

cc: